Subject: Jim Lange - A Guide to Beating the New Death Tax, the End of the Stretch IRA

"The SECURE Act could more appropriately be called the Extreme Death-Tax for IRA and Retirement Plan Owners Act. IRA and retirement plan owners should take action to protect their financial legacy."

We close the week with commentary by **James Lange** on the SECURE Act.

James Lange is a CPA, an attorney and a registered investment advisor. He has been quoted 36 times in The Wall Street Journal. He is the author of 7 best-selling books related to IRAs and retirement plans. His most recent ebook, Retirement Plan Owner's Guide to Beating the New Death Tax is available on amazon at this link: James Lange

Here is his commentary:

EXECUTIVE SUMMARY:

The SECURE Act could more appropriately be called the Extreme Death-Tax for IRA and Retirement Plan Owners Act. IRA and retirement plan owners should take action to protect their financial legacy.

COMMENT:

Why The Death of the Stretch IRA Is Important

The ticking time bomb in the SECURE Act is an important provision which greatly modifies the required minimum distribution (RMD) rules for Inherited IRAs and retirement accounts. Subject to some exceptions, an IRA or retirement plan that you inherit will have to be distributed and taxed within 10 years of the original owner's death - effectively cementing "the death of the stretch IRA." Prior to the passage of the spending bill, a non-spouse beneficiary of an Inherited IRA was permitted to minimize their tax burden by limiting distributions from the Inherited IRA to, depending on their age, a relatively small required amount - in effect, "stretching" it over the course of his or her lifetime. "Stretching" the Inherited IRA allows the beneficiary to keep the bulk of the Inherited IRA in a tax-deferred environment (for traditional IRAs) or tax-free environment (for Roth IRAs).

Eliminating the Stretch IRA robs IRA beneficiaries of decades upon decades of tax-deferred or tax-free growth. Even more importantly, it subjects the beneficiaries of traditional (tax-deferred) retirement plans to massive income-tax acceleration. This will be especially brutal if the beneficiaries of the inherited IRA are working and have income of their own. If so, the added income from the acceleration of withdrawals from the Inherited IRA could be taxed at an even higher rate. The change in these rules will result in a windfall to the IRS of billions of dollars at your children's expense.

Exceptions to the SECURE Act?

The most important exception to the SECURE Act is that the law does not apply to IRAs that you leave to your surviving spouse. Your surviving spouse can do a trustee-to-trustee transfer of your IRA at your death, which effectively allows them to treat that IRA as their own.

Non-spousal heirs who are not more than 10 years younger than the original IRA owner are also exceptions to the provision in the SECURE Act. This would most likely apply if you were to leave an IRA to a sibling or an unmarried partner.

Disabled and chronically ill beneficiaries are exempt from the onerous distribution provisions of the SECURE Act. The SECURE Act also provides an exception for children *while they are still considered minors* according to the law of the state in which they live. Once the minor reaches their majority, then the 10-year clock starts ticking.

Some of the Goodies in the SECURE Act

The SECURE Act has been promoted as an “enhancement” for IRA and retirement plan owners because it includes some “Gift Horse” provisions that, subject to exception, are relatively insignificant for IRA and retirement plan owners who are retired or close to retirement.

The SECURE Act offers expanded opportunities for small employers to join “open multiple employer plans.” This will be good for participants because it may increase investment options and reduce costs. The SECURE Act will increase opportunities for more lifetime income options in employer’s retirement plan – a provision that was pushed for by insurance companies that offer annuities. In addition, part-time workers who were previously excluded are now permitted to participate in their employer’s 401(k) plans.

One provision in the SECURE Act that is very good for almost every IRA and retirement plan owner is the section that advances the RMD age to 72 instead of age 70½. For many IRA owners, one of the best defenses against the death of the Stretch IRA will be to do a series of Roth IRA conversions, preferably during the years after they stop working but before they are required to take minimum distributions from their own retirement plans. Once they are required to take taxable distributions from their traditional IRAs, IRA owners may find themselves in a higher tax bracket and it may not be favorable to execute a Roth IRA conversion. The change in the RMD rules will give many IRA owners two additional years of lower income to proactively make Roth IRA conversions before their RMD kicks in.

More Opportunities for Backdoor Roth IRA Contributions

Another bit of good news is that SECURE Act also eliminates the age 70½ cutoff for making traditional IRA contributions and allows workers of any age to continue adding to their retirement savings. This will make it easier for seniors to make IRA contributions and even more “back door” Roth IRA contributions, currently blessed by the Tax Cuts and Jobs Act. The backdoor Roth IRA is a technique where you set up and make contributions to a Traditional IRA because your income is too high for you to contribute directly to a Roth IRA. Then, assuming you don’t have any other money in an IRA, you immediately convert the contribution you made to a Traditional IRA, to a Roth IRA. In effect, it is a method of getting around the IRS’s income limitations on a Roth IRA contribution. This technique, something I have been doing and advocating for years, will now be available to working seniors. (There was never an age limitation on Roth IRA conversions, just traditional IRA contributions.)

The SECURE Act Is Bad for Retirees

The SECURE Act will put hard working IRA and retirement plan owners at an extreme disadvantage. The deal all along was that if you put money in an IRA or retirement plan, your kids would get favorable tax treatment after you die. Now, late in the game, the government is effectively saying "we changed our minds and we are changing the rules." It's bad news, and a betrayal of those Americans who saved for years in their retirement plans. The government made a set of laws and we relied on those laws, making major sacrifices to contribute to our IRAs and retirement plans. The legal term for this is "detrimental reliance." Unfortunately, in this case, we can't sue the government. All we can do is to radically change our planning to protect our families.

Beating the New Death Tax

Though the circumstances of every taxpayer are unique, there are certain strategies that will help many IRA and retirement plan owners beat the new death tax. A common theme among these recommendations is to die with a lower balance in your Traditional IRA or retirement plan so it will not be clobbered with taxes so quickly after you die.

Roth IRA Conversions

I have written previous posts about the benefits of Roth IRA conversions on Forbes.com. And in their 2019 Investment Guide, Forbes Magazine published an excellent story on the benefits of Roth IRA conversions. If timed correctly, and for the right taxpayer, Roth IRA conversions can be an effective strategic planning tool and a very good response to the death of the Stretch IRA.

Social Security Planning

If you have not already applied for Social Security (or even if you have and are younger than 70 years old), you may benefit from reconsidering your Social Security strategy. If you haven't applied, consider waiting until age 70 to do so. The monetary value of postponing future benefits from age 66 to 70 will be to increase your benefit by 8% per year for you, and potentially for your surviving spouse, for the rest of your lives. If you are at least Full Retirement Age and have been receiving Social Security benefits, you can often choose to temporarily stop receiving benefits—that is, to postpone them to a later date. This will increase the value of your future benefits. The reason that a well-planned Social Security strategy can help you beat the new death tax is that, by holding off or stopping your Social Security checks, you will likely be able to reduce your taxable income. This may allow you to make bigger Roth IRA conversions, potentially at lower tax rates.

Review Your Estate Plan Including Wills, Trusts, and Beneficiary Designations of Your Retirement Plan

Thoughtful estate planning is critical. Reviewing and possibly updating your entire estate plan, including wills, trusts, and IRA beneficiary designations is a good idea for many IRA and retirement plan owners. This is particularly true if you have established trusts for any beneficiary or even a contingent beneficiary of your IRA or retirement plan. The use of disclaimers may offer flexibility to many estate plans. If you have any type of conduit trust in your existing estate planning documents, it may now do more harm than good. You should contact your attorney if your estate plan needs updating, because beating the new death tax could very well mean the difference of hundreds of thousands of dollars to your heirs.

Gifting

Many families should now consider gifting money to their children and grandchildren before their deaths. The source of those funds for the gifts could be distributions from your IRA, even reduced by the current income taxes on the withdrawal. Then, with the money that you have after paying taxes, you could make a gift to your family. This is another form of reducing the balance of your traditional IRA and beating the new death tax.

Of course, gifting could take on many flavors. It could be a straight-forward gift, “Here is some money.” It could be a contribution to a 529 plan (tax-free college funding mechanism). It could be money that your beneficiary might use to contribute to their own Roth IRA. It could even be paying premiums on a life insurance policy, the proceeds of which are tax-free.

Taking distributions from a Traditional IRA, paying taxes and gifting the remainder for 529 Plans, insurance policies, or your child's personal Roth IRA account is conceptually similar to a Roth IRA conversion. Effectively, you pay tax up front in return for tax-free income. One difference between doing a Roth IRA conversion and making gifts to your children is that the money you gift will not be in your estate.

Spend More Money

Most of my clients and readers don't spend as much money as they can afford to spend. When the tax ramifications of the SECURE Act sink in and they realize how their IRAs and retirement plans will be taxed unfairly after they die, maybe they will be more open to spending money now.

One of my favorite topics to discuss with clients is the benefit of taking their families on an annual vacation. My very first post on Forbes.com was about the benefits of taking your family on an annual vacation. If you can afford it, I recommend you do it every year. My family does. My 24-year-old daughter feels like she is part of a clan because she spends four days annually with her cousins and her 95-year-old grandfather, who pays for these gatherings every year. Those family memories that you leave behind will be a much more valuable legacy *than a big IRA that will get clobbered with taxes after you die.*

Charitable Gifting

Charitable gifting directly from a traditional IRA (called a Qualified Charitable Distribution, or QCD) can help reduce the balance in your IRA, and ultimately help your beneficiary beat the death tax on their inheritance. Another benefit of a QCD is that it reduces your current taxable income, potentially making a partial Roth IRA conversion more attractive.

Charitable remainder trusts as beneficiaries of traditional IRAs and retirement plans will likely become much more attractive as well. They will work wonderfully for many IRA and retirement plan owners who are charitably inclined, but our projections indicate that they will not likely be a great solution if you are not truly charitable.

The following point was true before and after the SECURE Act. Let's assume you want to leave $100,000 to XYZ charity. If you leave $100,000 to the charity in your will or revocable trust, then it will cost your family

$100,000. If you name the charity as the beneficiary of $100,000 of your IRA, the cost of the donation to your heirs might be only $65,000. This is because the charity is tax-exempt, but your heirs are not and might owe up to 35 percent in income tax when they withdraw money from the IRA. By changing the source of where your charitable dollars come from—from your will or trust, to the beneficiary of your IRA—you can dramatically decrease the taxes on your family while still providing for your favorite charities.

Sprinkle Trusts

Sprinkle trusts, when used optimally, might provide families with opportunities to beat the new death tax by spreading the tax burden from Inherited IRAs among multiple generations, including children, grandchildren and great-grandchildren. They could also be used to protect beneficiaries in vulnerable life situations by retaining the income for their benefit in the trust. Sprinkle trusts have been one of the many “tools” in the sophisticated estate planner’s repertoire for years. Now, they are much more attractive because they could result in significant tax benefits.

Things the Beneficiaries of Your IRA Should Know

The above points apply to individuals who own IRAs, but there are some things that IRA beneficiaries should be aware of too. If owners of Inherited IRAs are not proactive, the new death tax will cost them dearly.

If you have inherited a Traditional IRA, the best time to take a taxable withdrawal is when you are in your lowest tax bracket, as long as it is within ten years of the death of the IRA owner. If you inherit a Roth IRA, you should consider maintaining the tax-free growth in the account for as long as possible, and wait until ten years after the death of the original owner to withdraw any money.

This is no time for complacency for IRA and retirement plan owners. Congress is attacking your family’s financial security and it is time to take action.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Jim Lange

CITE AS: